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TAGS: ECON EFIN VE

SUBJECT: VENEZUELA: THE REVOLUTION ACCELERATES AS THE ECONOMY HEADS SOUTH

REF: A. CARACAS 87

B. CARACAS 368

C. CARACAS 330

D. CARACAS 778

E. CARACAS 407

F. CARACAS 305

G. CARACAS 731

H. CARACAS 690

I. CARACAS 307

J. CARACAS 581

K. CARACAS 155

L. CARACAS 149

M. CARACAS 643

N. CARACAS 750

Classified By: Economic Counselor Darnall Steuart for reasons 1.4 (b) and (d).

11. (C) Summary: As we approach the halfway point of 2009, two trends are clear in Venezuela's economy: state control is accelerating just as the economy enters a recession. Most analysts predict economic output to decline by 1.5 to three percent in 2009 as lower oil prices force the government of the Bolivarian Republic of Venezuela (GBRV) to rein in spending. This sobering outlook has not stopped the GBRV from expanding its control over the economy, however.

Empowered by the removal of term limits in the February constitutional referendum, President Chavez has nationalized companies in additional industry sectors and pushed the National Assembly to pass several laws increasing the state's economic power. These and other actions are damaging regional economies in key areas, including Zulia, Guayana, and Valencia. Survey results suggest concerns about the economy's direction are playing a role in a recent dip in Chavez's popularity, but there is no way of knowing whether or how these concerns might translate into a more serious challenge for Chavez. End summary.

Stagflation Approaches...

12. (U) The Venezuelan Central Bank (BCV) reported anemic growth of 0.3 percent in the first quarter of 2009 (with respect to the same period in 2008). After years of stellar but decreasing growth, the trend is clear: Venezuela's economy is all but certain to enter into recession in 2009, with most local analysts predicting a two to three percent

contraction. With oil prices significantly lower than in 2008, the GBRV has been forced to rein in spending, which had served as the main economic driver from 2004 on (ref A). The latest BCV statistics available indicate central government spending declined by 7 percent in nominal terms in the first two months of 2009 (relative to the same period in 2008).

13. (SBU) The "anticrisis" economic measures announced by Chavez in March amount to little more than a plan to finance the projected budget deficit by issuing local debt (ref B), a plan the GBRV has been aggressively implementing. To ensure a receptive local market, the BCV has loosened monetary policy. While many analysts have lowered their expectations for inflation for 2009 (from roughly 35-40 percent to 28-35 percent) as a result of a larger-than-expected contraction and GBRV efforts to control food prices, they generally expect inflation to be higher in 2010 than 2009, partly as a result of the BCV's accommodating monetary policy. BCV data and pollsters' numbers indicate that many Venezuelans are suffering declining purchasing power. In the last quarter of 2008 and the first quarter of 2009, accumulated inflation was 12.6 percent while compensation to salaried workers rose only 2.7 percent, according to BCV figures.

...And Chavez Tightens the Economic Screws

14. (SBU) Even as the economy heads toward stagflation, Chavez has stepped up his campaign to increase central government control after a relative hiatus beginning in the run-up to the November 2008 regional elections and lasting

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through the February 2009 referendum. Specific GBRV actions in recent months include: nationalizing ports and airports (March 12; ref C), and then port service companies (mid-June, ref D); announcing the seizure of Venezuelan carrier Aeropostal (March, ref E); nationalizing a Cargill rice plant (March, ref F); banning the sale of Coca Cola Zero for unsubstantiated health concerns (June, ref G); reaching an agreement for the nationalizations of Banco de Venezuela, which the GBRV will take over July 3, and steel-maker Sidor, which the GBRV had already taken over (May, ref H); taking over more agricultural lands (ongoing, ref I); expropriating the assets of numerous oilfield service companies, including several whose operations are critical to production (May, ref J); and, most recently, decreeing the nationalization of iron briquette companies in Guayana, making it illegal for construction companies to adjust prices for inflation, passing a law mandating state control over the petrochemical industry, and opening debate on a law over "social property."

15. (C) While nationalizations are not new to Venezuela, the pace has picked up again. The best explanation we have heard as to why comes from Rafael Munoz (strictly protect throughout), a political economist at Banco Mercantil. On the one hand, Munoz argues, Chavez has sufficient liquid reserves in quasifiscal funds that he is not forced to negotiate with other economic actors. On the other hand, the current window between the February referendum and future electoral challenges, such as National Assembly elections scheduled for 2010, offers Chavez an important opportunity to consolidate his political and economic control in what is at its core a totalitarian project. The actions mentioned in the preceding paragraph represent the gamut of GBRV tactics for increasing economic control, from outright expropriation to harassment of private companies to legal changes that pave the way for future state actions.

The Revolution is Coming Closer

16. (C) While the general economic situation affects all Venezuelans, several of our contacts believe Chavez's

specific actions are directly affecting a growing proportion of the population. Munoz believes there is a palpable sense among even Venezuelans of modest means that "the revolution is coming closer" in the sense of potentially affecting their humble aspirations. Another contact, who advises on mergers and acquisitions, noted recent government actions are harming key regional economies, including Zulia (via recent service company nationalizations); Guayana (via the briquette nationalizations and the continued consolidation of economic activity under the state-owned Corporacion Venezolana de Guayana; and Valencia (where government control over key imports for automobile assemblers (ref K) has led to widespread work stoppages). The government's accelerated drive to control the economy is having international repercussions as well. Media reports indicate that the Japanese Bank for International Cooperation is rethinking a potential USD 1.5 billion loan to PDVSA and that Argentine industrialists have expressed their displeasure to President Kirchner over the ongoing nationalizations. (Note: Both Japanese and Argentine companies had interests in the briquette manufacturers; Japanese companies have interests in the petrochemical sector as well. End note.) On the other hand, there are indications that companies from countries considered friendly by the GBRV are being favored in other situations (ref L).

Increasing Tension, No Clear Outlet

¶7. (C) If many of our contacts think economic tensions are rising, no one has a clear sense of whether or how they might translate into a political challenge for Chavez. There are some preliminary indications that more Venezuelans believe President Chavez is responsible for the country's economic problems, but no clear evidence of a trend. There has been an increase in labor unrest, but the labor movement as a whole is divided and confused, according to a prominent labor

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analyst (ref M). Munoz, who has studied the political, social, and economic factors behind the 1989 uprising known as the Caracazo, believes current conditions are equally ripe for large-scale public unrest. He points to the deteriorating economy, a growing sense that one cannot get one's problems resolved through current political institutions (including opposition parties, and especially given the possibility of indefinite reelection), and the feeling that the revolution is hitting closer to home. Just because the conditions are ripe, Munoz cautions, does not mean a generalized reaction will happen, nor does it allow us to predict when, where, and why it might.

Comment

¶8. (C) Even with the steady rise in oil prices from January through June, 2009 is shaping up as a grim year economically for Venezuela. While economic problems could conceivably cause or contribute to a serious political challenge for President Chavez, it would be wrong to assume they will. Given Chavez's already significant political and economic control and ability to repress selectively actors who challenge this control (ref N), there is no obvious channel for discontent over economic problems to express itself in a generalized way. End comment.

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